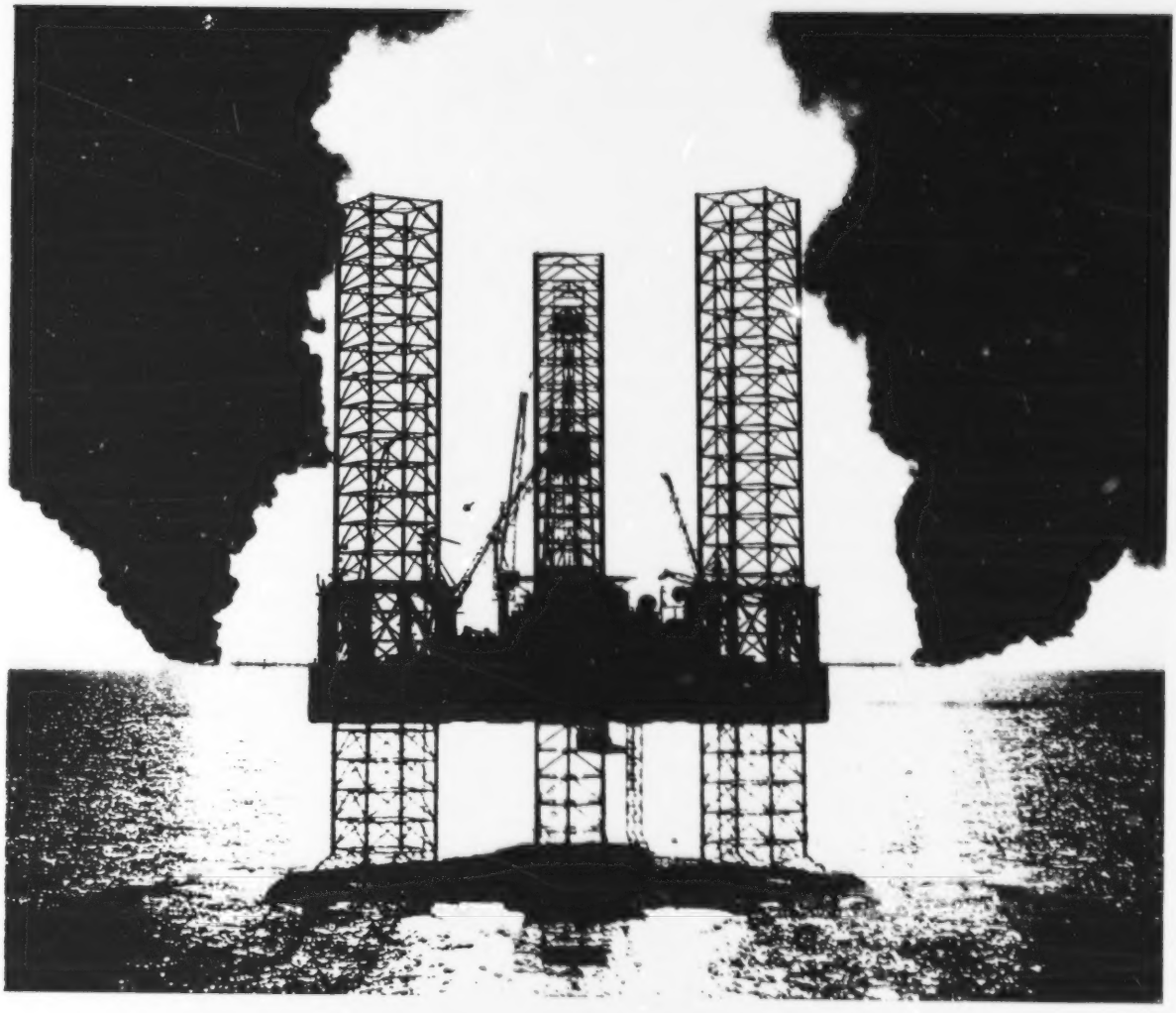

Nova Scotia Resources Limited • 1985-86 Annual Report

86-06063/

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CORPORATE OFFICES

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CORPORATE PROFILE

Halifax waterfront

*A Crown corporation of Nova Scotia established in 1981 to acquire and manage, in partnership with the private sector, participating interests in projects to develop petroleum, energy and mineral resources, and investments in related industrial activities.

*Holds major petroleum rights, including interests in the Venture Gas Project and eleven significant hydrocarbon discoveries offshore Nova Scotia.

*Actively exploring for gold and associated minerals in Nova Scotia.

1985/86

OPERATING HIGHLIGHTS

*Participated in 11 exploration/ delineation wells on the Scotian Shelf, six of which tested hydrocarbons. Among these were the Cohasset delineation well, which tested high flows of light gravity oil from 6 intervals, and the North Triumph gas discovery.

*Conducted its first self-managed offshore operation, an 1125 mile (1800 km) seismic program west of Sable Island.

*Applied to the National Energy Board to export to U.S. purchasers its 10% share of total export gas volumes from the Venture Gas Project.

Cohasset oil test flare

MESSAGE FROM THI

During this period of transition and adjustment for the petroleum industry, the Company continued an intensive program of offshore drilling, participating in eleven exploration/delineation wells, of which more than 50% tested hydrocarbons. Our initiatives resulted in participation in a significant gas discovery at North Triumph, and in the major oil success at Cohasset. The drilling of the Cohasset well, in particular, demonstrates the Company's ability to pursue strategic prospects that might otherwise be ignored, and have them drilled by the industry.

The Cohasset structure, limited in size but potentially prolific, is an example of the potential for technically and economically manageable reservoir development that should attract new investment into the Nova Scotia offshore.

In summer 1985 we also conducted our first self-managed offshore operation, a 1125 mile (1800 km) seismic program over prospective oil-bearing targets west of Sable Island.

Throughout the year the Company participated actively in Venture Gas Project (VGP) group studies to confirm the proven gas reserves within the project, the filing of a detailed gas export application before the National Energy Board, and exploration drilling seeking to add to proven Project reserves.

We successfully negotiated a financial transaction that will convert to cash a portion of the Company's accumulated exploration expenses and achieve immediate cash flow. This transaction (described on page) contributed $2.6 million to the Company's net cash flow to March 31, 1986.

In addition the Company increased its interest in the Inco-managed SCOMINEX gold exploration program, which has identified a number of encouraging gold-bearing areas for further intensive evaluation.

During the year, two events occurred that will directly affect the thrust of Canadian frontier exploration and the near-term pace of activity on the Nova Scotia offshore. The first was the announcement in fall 1985 of a new federal exploration, fiscal and tax policy. The policy includes replacement of the Petroleum Incentives Program — due to expire March 31, 1986 — with a tax-based incentive, the Exploration Tax Credit. For companies not currently paying income taxes, the new incentive program would dramatically increase the cost of exploration. Unless additional funding from government or other sources becomes available, the Company will be severely disadvantaged in future exploration relative to its taxpaying partners.

The second event, a 60% decline in world crude oil prices during first quarter 1986, was precipitated by OPEC's decision to abandon official crude selling prices in order to "secure and defend for OPEC a fair share of the world oil market" and to maintain production levels necessary to achieve its market share/production balance. As a consequence companies active in or contemplating Nova Scotia offshore exploration were obliged to refrain from committing to expenditures beyond those strictly necessary to meet existing Exploration Agreement requirements or to retain prospective land blocks.

Outlook 1986/87

Although cash flow restrictions today confronting the petroleum industry dictates its caution in undertaking new expenditures, there is no reason to presume any change in the commitment of the Venture Gas Project participants to continue toward project development. Our own gas pricing, project cost and economic assumptions continue to support the conclusion that the VGP, given a realistic fiscal framework for development, would be commercially viable on the basis of its existing established gas reserves.

A combination of circumstances has enhanced, in our view, the exploration attractiveness of the Scotian Shelf. Some of these are:

- the increasing number of hydrocarbon discoveries in accessible, ice-free, shallow water areas that can be developed with standard,

PRESIDENT

lower-cost technology, of which Cohasset is perhaps the clearest example;

- the high geological prospectivity of the unexplored George's Bank area, also in relatively shallow water;
- a decline in offshore drilling rates and an increased drilling efficiency which have together reduced net well costs offshore Nova Scotia substantially below 1984 costs;
- the elimination from near-term exploration activity of remote, high-cost areas of the Canadian frontier, coupled with an irreversable decline in Canadian conventional crude oil production. The industry's search for oil reserve replacements should be increasingly attracted to the relatively low-cost Nova Scotia offshore.

As a background to these positive elements, we believe that world oil prices will stabilize and move toward recovery in the last quarter 1986. At the time of writing, OPEC has obtained an increased market share for its oil that meets and even exceeds its targets. This must improve prospects that OPEC will achieve oil price stabilization above U.S. $15 per barrel.

Strategic Objectives

Given the Company's level of corporate investment and its central position in the Nova Scotia offshore, we have 5 strategic business objectives:

1. Restructure the Company's corporate financing on a lower cost basis, while retaining borrowing flexibility.
2. Through the Province, seek federal government funding to place the Company on the same exploration-cost footing as current taxpaying companies able to fully utilize offshore exploration tax credits. This will allow the Company to aggressively seek partners to drill promising oil and gas prospects in the shallow water regions of the Scotian Shelf.
3. Encourage and assist our industry partners to rapidly complete Cohasset reservoir, technical and economic evaluations and to negotiate an appropriate fiscal framework that will ensure an early commitment to Cohasset development.
4. Continue to pursue Venture Gas Project development parameters that will allow regulatory approvals to be expeditiously obtained in Canada and the United States while preserving Project momentum.
5. Seek new investments, financeable on a non-recourse basis, that will generate early cash flow and diversify the Company's asset base.

During the remainder of the 1980's we expect crude oil prices to steadily recover toward a level of at least U.S. $20 per barrel. The decline in Canadian conventional crude production and the absence of further frontier and unconventional oil development means that by the 1990's virtually all eastern Canada's refining requirements will be based on imported oil.

In such circumstances, it is reasonable to expect federal government policy to encourage development of new Canadian production from, at least, lower cost frontier areas. In addition, it continues to be clear that the current gas surplus in the United States will have disappeared by 1989 and markets to secure from Canada long-term gas supplies, particularly in the northeast United States, will be strong.

As throughout the petroleum industry, current conditions affecting the Nova Scotia offshore are uncertain. But we have reason to be confident of a relatively early renewal of exploration activity and of the ultimate production of oil and gas. Participating in this industry, as in the development of major projects, requires patience and the long view. The key is to utilize opportunities presented at both the top and bottom of the industry business cycle, while maintaining progress toward our longer term goals.

Peter A. Outhit
President and Chief Executive Officer

June 1986

OPERATIONS: OIL AND GAS

SUMMARY OF 1985/8

During the 12 months to March 31, 1986, the Company pursued a very active level of offshore drilling (details below). Of twelve wells in which NSRL participated with interests ranging from 5% to 25%, five discovered or tested gas and condensates, one (Cohasset) produced major oil flows, one was spudded and later terminated as a standby relief well during Venture N-91 control operations, four were dry holes, and one well was drilling at fiscal year-end.

At the end of June 1985, Mobil effected a successful "top kill" and set a deep cement plug in the West Venture N-91 well, bringing to a conclusion a difficult and expensive ten-month operation to regain well control. Most of the Company's 10% share of the associated costs, including the initiation and termination of two standby relief wells, was covered by the Company's insurance policies; 80% of the remainder was recovered through Petroleum Incentive Payment grants. Because the escape of gas from deep gas-bearing zones to shallower zones affected the integrity of logging and measurement data, no gas reserves could be attributed to the N-91 structure.

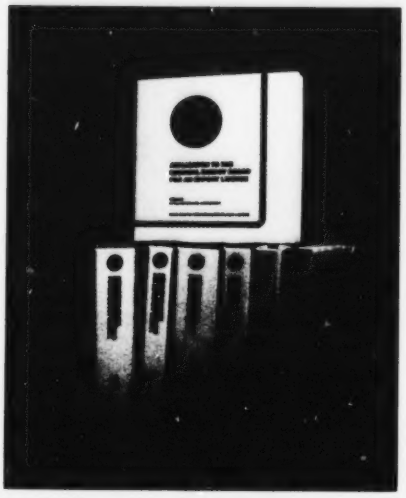
Well					
Well Type					
Operator					
NSRL Interest					
Rig Release	30/5/85	13/6/85	04/7/85	04/7/85	30/7/85
T.D. ft. (m)	18585 (5666)	13130 (4003)	18195 (5547)	11911 (3631)	11611 (3540)
Results Status	D & A	D & A	GAS	D & A	D & A

VENTURE GAS PROJECT

During 1985/86 the Venture Gas Project (VGP), in which the Company holds a 10% interest, continued to move toward development despite the fact the Thebaud I-93 and West Olympia O-51 wells did not add significantly to gas reserves, and the severe depression in oil prices occurring in first quarter 1986. Throughout the year the principal efforts of the joint venture were concentrated on confirming, by detailed analysis, the level of gas reserves assigned to the Venture, South Venture and Thebaud structures, while continuing to conduct exploration drilling to enhance those reserves.

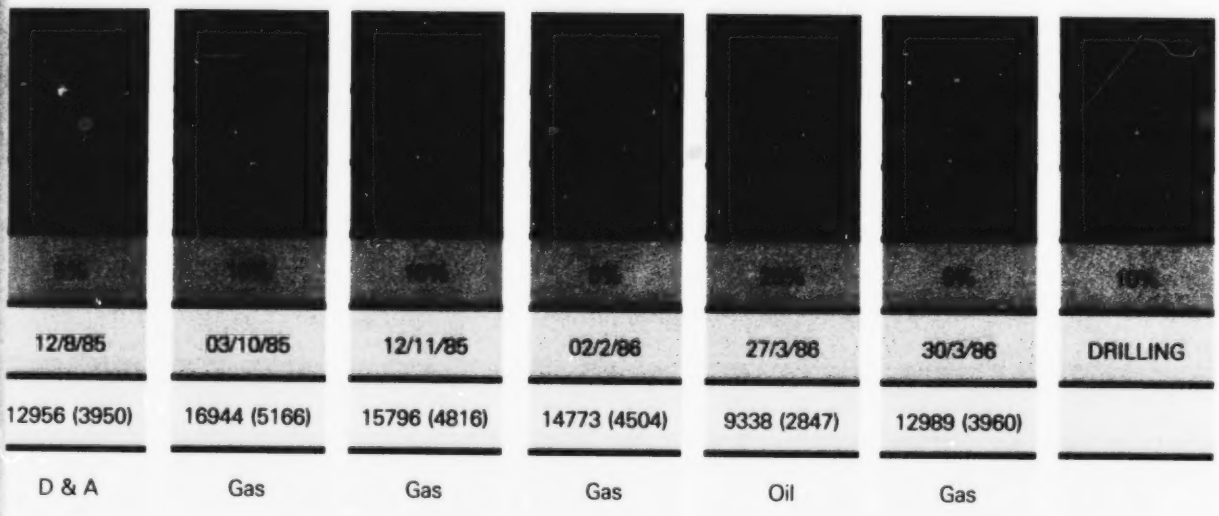
In addition, the Venture group completed comprehensive studies to optimize the design and cost of alternative development facilities. These studies indicate that development costs can be significantly reduced. The group also undertook a detailed evaluation of the technical and economic possibilities of a project development based on the level of currently confirmed VGP reserves. Its results will be reviewed by the VGP participants in spring 1986.

In July 1985 the Company and each of the other VGP participants filed separate but concurrent applications to the National Energy Board for permission to export gas to markets in the northeast United States at a combined level of 300 million cubic feet (8.5 million cubic meters) of gas per day. The Company requested a licence to export to its purchaser, NESP



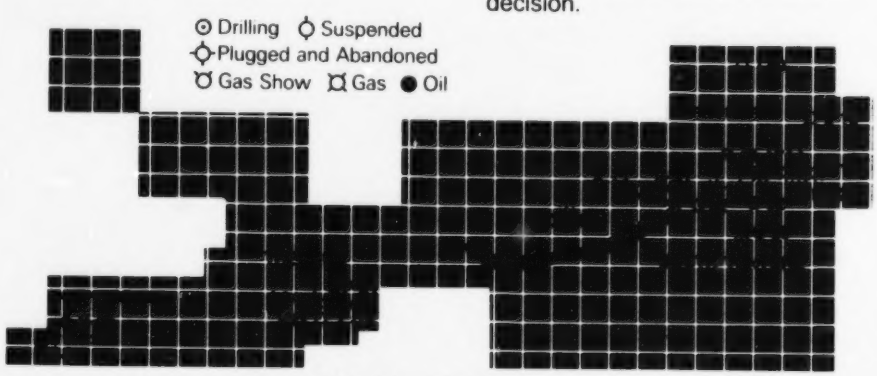
7 volume Export Gas Application

›RILLING PROGRAM



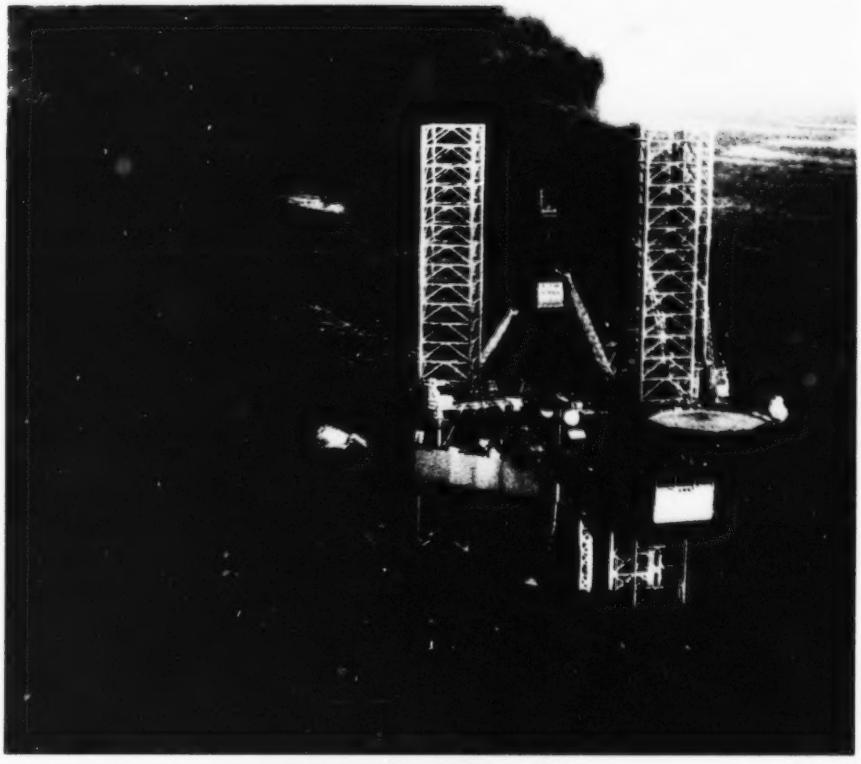
Supply Corp. (owned by three U.S. interstate pipeline companies) 30 million cubic feet (.85 million cubic meters) of gas per day for a term of 20 years plus a one year take-or-pay makeup period, representing a total volume exported of 230 billion cubic feet (6.5 billion cubic meters) of gas. The Company's application also proposed to make available for the development of markets in the Maritime provinces, if and as required, up to a total of .7 billion cubic feet (19.2 million cubic meters) of gas during any consecutive twelve month period.

During the year Sable Gas Systems Limited (SGSL) in which the Company is a nominal shareholder with TransCanada Pipelines, announced its intention to file application with the National Energy Board to construct facilities to transmit offshore gas to export markets when the VGP participants commit to Project development. SGSL subsequently stated that it had completed all application preparatory work and would reduce project staff and head office costs pending the VGP development decision.



Sable Island Block

COHASSET OIL PROJECT



Rowan's Gorilla I jack-up test Cohasset Oil — March 1986

The Company's 25% participation in the Cohasset A-52 oil well represents a major exploration success. Test results announced March 27, 1986 reported high flow rates of sulphur-free light gravity oil from six intervals as follows:

Test No.	Interval ft. (m)	Oil bpd (m³/day)	Choke in inches	° API Gravity
1.	7825-7837 (2385-2388.5)	7740 (1230)	44/64	51.7
2.	7668-7681 (2337-2341)	5600 (890)	52/64	53.7
3.	7395-7405 7435-7446 (2254-2257) (2266-2269.5)	5030 (800)	48/64	51.8
4.	7287-7304 (2219-2224)	4430 (705)	52/64	50.8
5.	7081-7084 (2149-2150)	1320 (210)	32/64	49.7
6.	6970-6972 (2113-2113)	5170 (810)	52/64	46.4

The Cohasset structure was discovered by the Mobil D-42 well in 1973, which production tested about 1500 bopd from three zones. The 1978 Cohasset P-42 appraisal well, drilled 6,000 feet northeast of D-42, penetrated only water-bearing zones. It was the judgement of NSRL, based on analysis of the wells and subsequent seismic data, that the P-42 well had been drilled below the oil/water contact and that the Cohasset reservoir extended in a different direction. For more than two years NSRL sought a commitment from participants in the Sable Island block, which contains the structure, to drill a further delineation well. In the fall of 1985 Petro-Canada agreed to propose the A-52 well as an independent drilling operation. Mobil declined to participate, and accordingly the interests of the Company and of Petro-Canada were increased to 25% and 66% respectively in the section containing the well. The Company's final interest in the Cohasset structure will be fixed according to Mobil's elections whether to reacquire its interest in the A-52 well section and/or participate in further Cohasset development.

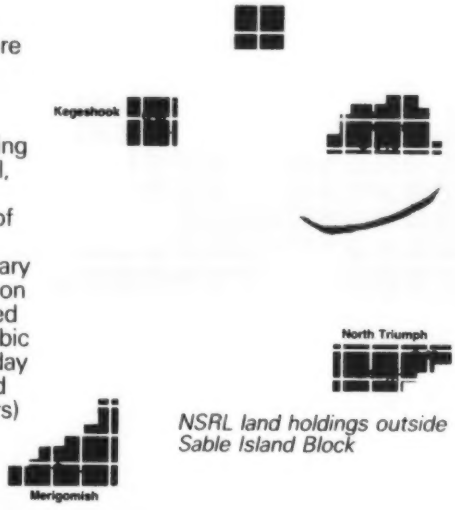
The Cohasset group will be undertaking a detailed technical evaluation, including reservoir analysis, modes of production and commercial aspects, to be completed in late 1986. In addition, a 3-D seismic program will be conducted over the structure in summer 1986. The Company has commenced its own evaluation of potential project development so as to minimize delay in achieving with the other Cohasset participants a firm plan for development.

NORTH TRIUMPH DISCOVERY

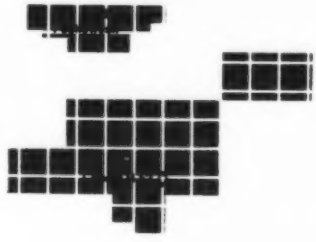
The Company's participation in the Shell-operated North Triumph G-43 gas discovery well and in the followup North Triumph B-52 well is likely to add significantly to the Company's gas reserves. North Triumph is located between the Glenelg and Alma gas-bearing structures about 18 miles (30 kilometers) south of Sable Island and will have strategic importance to the commercial development of greater Scotian Shelf reserves beyond the Venture Gas Project.

The Company earned its 5% interest in North Triumph by paying 10% of the cost of the G-43 well, which was drilled in 253 feet (77 meters) of water to a depth of 14,773 feet (4504 meters). The discovery announcement in January 1986 reported two zones tested on a 15/16" choke with gas recovered at rates of 35.2 and 37 million cubic feet (100,000 cubic meters) per day with condensate rates of 160 and 200 barrels (25 to 32 cubic meters) per day.

As a result, the North Triumph participants immediately spudded the followup delineation well North Triumph B-52, approximately two miles (three kilometers) southwest of G-43. On March 27, 1986, it was announced that tests of the principal producing zone recovered gas on a 44/64" choke at the rate of 27.5 million cubic feet (778,250 cubic·meters) per day and minor amounts of condensate. The North Triumph participants are analyzing well data to determine the level of potential reserves in the structure before deciding on future development activities.



NSRL land holdings outside Sable Island Block



⊙ Drilling ◇ Suspended
◈ Plugged and Abandoned
Ø Gas Show ⌑ Gas ● Oil

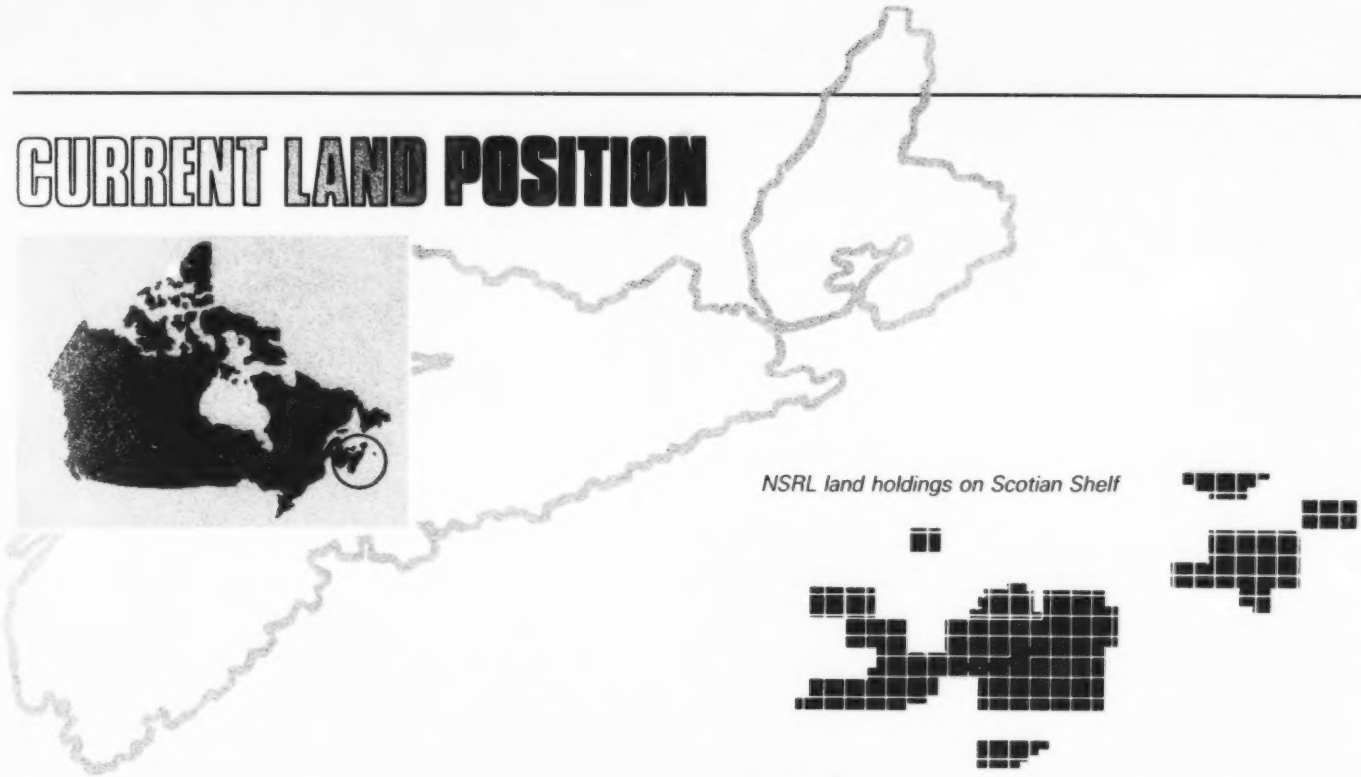
NSRL SEISMIC PROGRAM

Seismic vessel "Western Caribbean" conducts program

In June 1985 the Company conducted its first self-managed offshore operation, a high resolution seismic exploration program west of Sable Island. Eighty percent of the $1.9 million program cost was recovered through Petroleum Incentive Payment grants, the last major offshore seismic program eligible for these grants.

The 1125 mile (1800 kilometer) program was designed to identify potential oil/condensate bearing prospects within the Logan Canyon sands overlying the Abenaki platform edge. Data processing has been completed and interpretation of the results is ongoing, constituting a valuable asset in the Company's strategy to obtain land interests covering attractive shallow water prospects and to secure the drilling of those prospects at an early date.

CURRENT LAND POSITION



NSRL land holdings on Scotian Shelf

Exploration rights with respect to offshore lands in which the Company holds an interest, other than areas recognized as a Significant Discovery Area by the Canada/Nova Scotia Offshore Oil and Gas Board, are subject to relinquishment effective on the expiration of the applicable Exploration Agreements.

In November 1985, 50% of the Mobil-operated Sable Island block covered by EA 255, in which the Company holds a 10% interest, was relinquished following an acreage selection process which enabled the Company to retain its interest in eleven Significant Discovery Areas and a number of Work Prospect Proposed Areas and Minimum Land Blocks. The primary term of EA 255 will expire on the later of July 15, 1986 or rig release from the currently drilling Thebaud C-74 well. Negotiations conducted in spring 1986 will determine the exploration commitments applicable to its renewal.

All lands covering structures dedicated to the Venture Gas Project are within a separate Exploration Agreement (EA 254) and are exempt from relinquishment. With the expiry of EA 254 in December 1985, most of the VGP lands were placed within two Significant Development Areas and the remaining portion rolled into EA 255.

EA 250, covering the Home Oil-operated East Sable block in which the Company holds an interest of about 20%, expired December 16, 1985. Negotiations prior to that date have secured its renewal for three years with no rentals applicable to the first year and no specific work requirements. Work carried out during the renewal term will be credited against rentals in the second and third year on lands not relinquished.

Through other farm-ins, the Company has earned a 5% working interest in four additional Exploration Agreements.

At March 31, 1986 the Company's offshore land position was as follows:

	Sections	Gross Acres	Net Acres
EA 254 (Venture SDA)	28	25,676	2,567.6
EA 255 (Sable Island - includes 11 SDA's and 5 WPPA/MLB's)	606	556,296	51,517.8
EA 150 (East Sable)	327	298,435	61,701.0
EA 118 (South Desbarres)	50	45,724	2,286.2
(Kegeshook)	50	45,662	2,283.1
EA 119 (Peskowesk)	49	44,567	2,228.4
EA 120 (North Triumph)	49	45,173	2,258.6
EA 122 (Merigomish)	49	45,279	2,264.0
TOTALS	1208	1,108,812 (447,714 ha)	127,106.7 (51,427.6 ha)

CHANGES TO

FRONTIER ENERGY POLICY

In fall 1985 the governmental policy for offshore exploration and development was changed so as to significantly alter future exploration rights as well as the tax and fiscal regime applying to offshore activities. This will affect both the nature and level of the Company's offshore activities. The first step was taken to implement this policy in December when Bill C-92, the Canada Petroleum Resources Act, was introduced to Parliament to replace the Canada Oil and Gas Act of 1982. Features of the proposed legislation:

- Frontier exploration rights will be issued through Exploration Licences, to be succeeded by a Significant Discovery Licence should significant accumulations of hydrocarbons be discovered, with the subsequent right to a Production Licence for commercial production.
- Frontier exploration rights will be issued on a competitive "best bid wins" basis, i.e. the largest committed expenditure conforming to geological prospectivity and policy objectives.
- Petroleum Incentive Payments will be replaced by a 25% Exploration Tax Credit (ETC) applicable to exploration expenses above $5 million per well. For companies not in a current taxpaying position, 40% of the ETC is refundable in cash. In addition, a 25% investment royalty credit applicable to new exploration well costs not exceeding $5 million will be applied against royalties otherwise payable within the region.
- Elimination of the 25% Crown Share provision.
- For discoveries made after March 1982, a 50% Canadian ownership level is required for a Production Licence. For current developments with COR deficiencies, methods are specified to allow the interest holders to increase to the 50% COR level or for a competitive auction to be required to achieve this level.
- The current 10% basic royalty and 40% progressive incremental royalty is replaced by a royalty that, prior to project investment payout, begins at 1% of gross revenues and gradually rises to 5% over 72 months. After payout of investment and a fair return on capital invested, the royalty increases to 30% of net cash flow. Definition of "payout" is subject to consultation with industry and governments affected, and the federal Cabinet is authorized to approve reductions or exemptions of royalty payments in specific cases.

PROPOSED ISSUANCE OF

OFFSHORE BLOCKS

In February 1986 the Canada/Nova Scotia Offshore Oil and Gas Board requested nominations by April 30, 1986 for offshore land blocks to be posted in a Call for Bids planned to be issued in the second quarter 1986. Bids, which close after 120 days, will be evaluated on the basis of committed expenditure (the work bonus). Issued rights will have a term of six years (Scotian Shelf) or eight years (Scotian Slope) divided into two equal periods. A well must be drilled in the first period to validate rights for the second period. A deposit of 25% of work bonus bid is refundable against money expended. Second period rentals are refundable against work expenditures during that period.

It is the Company's intention to nominate suitable land blocks for posting and to seek industry partners to submit successful work bonus bids on selected blocks.

OPERATIONS: MINERALS

GOLD

During 1985/86 the SCOMINEX joint venture, formed in 1984 by Inco Limited (manager), Husky Oil, Kennco Limited, and the Company's subsidiary COREL (each holding a 25% interest) completed its first full year of province-wide gold exploration. SCOMINEX is committed to expend a minimum of $3 million in exploration over the years 1985-86-87 and currently holds seven major properties covering 3,897 claims comprising 155,880 acres throughout Nova Scotia.

In December 1985, Kennco Limited closed all its Canadian operations and relinquished its interest in SCOMINEX which was redistributed equally between Inco Limited and NSRL. NSRL's total direct and indirect interest in SCOMINEX therefore increased to 25.8%.

The major emphasis of SCOMINEX has been to seek large tonnage gold deposits in settings comparable to those being developed elsewhere in Canada. A number of other geological environments have also been investigated. Major reconnaissance surveys, focussing on geochemistry, were conducted in southeast Cape Breton, the Cape Breton Highlands and the Antigonish Highlands with encouraging results.

In addition to its direct-held properties, SCOMINEX carries out exploration through Inco with other prospecting companies, whereby SCOMINEX will fund certain prospecting costs and in return receive the right to assume a predominate interest in properties acquired through this effort.

Followup sampling, mapping and prospecting is currently being carried out in all of the above-mentioned areas. In addition, detailed evaluations have been carried out at Cochrane Hill and Goldenville (Guysborough County) and Molega (Queens County) that included more than 15,000 feet of core drilling. An intensive program of work will be conducted in 1986 at the Cochrane Hill gold property to test continuity of mineralization and grade and to achieve an increase in potential tonnage. The Company is optimistic regarding the viability of this deposit.

Diamond driller extracting drillrods.

COAL

Mining activities of the Company's subsidiary, Novaco Limited continued until the end of May 1985 when operation of its Point Aconi, Cape Breton, near-surface coal mine was completed. A total of 960,238 tons of coal were produced and marketed from Point Aconi over its five year life. Almost all production from the mine was sold to the Nova Scotia Power Corporation for electrical generation.

Progressive reclamation of mined areas, which continued during mining operations, ensured that full site reclamation was complete by the end of summer 1985. A feature of this work was the levelling, clearing and seeding of a 7.5 acre recreational area dedicated to the Point Aconi community and officially opened in September 1985.

In view of the current surplus in domestic coal supplies, a decision regarding further mining operations by Novaco has been deferred. Novaco is committed to restore the site of its near-surface mine of Rodney Seam in Springhill, where operations terminated in 1984, and has set aside funds for the purpose. Restoration work, in consultation with the Town of Springhill, will be conducted pending the outcome of ongoing private sector activity at the site.

Novaco continues to evaluate near-surface mining and waste reclamation opportunities in Nova Scotia and to advise the Province thereon.

OTHER ACTIVITIES

SYNFUELS

In July 1985 the Scotia Coal Synfuels Consortium, in which the Company holds a 19.5% interest, completed its four year investigation of the feasibility of liquefying coal from Cape Breton's Lingan Harbour seam. The subsequent filing of a final report with the governments of Canada and Nova Scotia, outlining results of single stage and two-stage testing and preliminary financial and economic assessments, discharged the consortium's mandate.

The Report recommended further work and studies, including the investigation of two-stage processes to improve product yield and plant economics. Research has been commenced by the Nova Scotia Research Foundation Corporation to ascertain the suitability to liquefaction of a range of Nova Scotia coals under several processes and is scheduled for completion in 1987. The objective is to achieve liquid yields sufficient to form a technical foundation for undertaking further expenditures to determine project feasibility.

The Report recognized that the project would require substantial government financial support in order to achieve commercial viability.

The Company has access to information from the ongoing research and intends to review synfuels project potential when the final results of this research are in hand.

WESTERN CANADA TRANSACTION

In summer 1985 the Company entered into a transaction which in effect will convert to cash a portion of its accumulated Canadian exploration expenses. The Company's taxable subsidiary, Nova Scotia Resources (Ventures) Limited, purchased from two Alberta petroleum companies a "reversionary working interest" in producing oil and gas properties, the purchase price for which was wholly bank financed against the production revenue stream, without recourse to the Company or the Province. The transaction carries no risk to NSR(V)L.

Revenues from production, after repayment of operating expenses, royalties, taxes, and bank financing, will provide a negotiated amount of net income to the Company. Taxability of the revenue stream is offset by a small portion of NSR(V)L's exploration expense pool which it would not otherwise be able to utilize for a lengthy period. When the net income target is realized — the timing of which is determined by the level of crude prices — the ownership of the properties automatically reverts to the sellers.

To March 31, 1986 the transaction generated net cash flow of $2.6 million, most of which was used to reduce the related bank indebtedness. After payout of the bank indebtedness, it is expected that the transaction will provide to the Company net cash flow in excess of $3.5 million.

To the Shareholders of
Nova Scotia Resources Limited

We have examined the consolidated balance sheet of Nova Scotia Resources Limited as at March 31, 1986 and the consolidated statements of income and deficit and changes in financial position for the year then ended, and have obtained all the information and explanations we have required.
Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion and according to the best of our information and the explanations given to us and as shown by the books of the Company, these consolidated financial statements are properly drawn up so as to exhibit a true and correct view of the financial position of the Company as at March 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Doane Raymond

Halifax, Nova Scotia
May 16, 1986

Doane Raymond
Chartered Accountants

Consolidated Balance Sheet

ASSETS	1986	1985
Current		
Cash and term deposits	**$ 11,335,174**	$ 12,671,888
Receivables	**7,251,286**	11,532,639
	18,586,460	24,204,527
Petroleum and natural gas investments (Note 2)	**114,408,643**	82,671,569
Equipment and leasehold improvements	**109,585**	126,385
Other assets (Note 3)	**4,669,964**	597,226
	$137,774,652	$107,599,707
LIABILITIES		
Current		
Bank indebtedness (Note 4)	**$ 46,764,523**	$ 38,536,796
Payables and accruals	**5,594,788**	2,751,767
Deferred grants	**362,528**	372,674
Current portion of long term debt	**1,840,000**	
	54,561,839	41,661,237
Long term debt (Note 5)	**81,117,320**	61,349,527
Other loan		262,583
	135,679,159	103,273,347
Deferred income taxes		812,556
Minority interest	**3,281,236**	2,750,507
SHAREHOLDERS' DEFICIENCY		
Capital stock		
Authorized		
40,000 common shares without par value		
Issued and outstanding		
3 common shares	**3**	3
Retained earnings (deficit)	**(1,185,746)**	763,294
	(1,185,743)	763,297
	$137,774,652	$107,599,707

ON BEHALF OF THE BOARD

Director

Director

Nova Scotia

Consolidated Statement of Income and Deficit

For the year ended

	1986	1985
Income		
Petroleum and natural gas (Note 6)	**$ 7,423,723**	$
Royalties	**(2,333,815)**	
	5,089,908	
Interest	**1,029,115**	973,889
Income (loss) from near surface coal resource operations	**(317,424)**	133,787
Other revenue	**48,725**	69,900
	5,850,324	1,177,576
Expenses		
Petroleum and natural gas operating expenses	**992,097**	
Non-capitalized financing charges	**2,753,312**	505,721
General and administrative	**544,489**	764,297
Depletion and depreciation	**2,309,302**	32,014
Petroleum and gas revenue tax	**170,761**	
Write-off of petroleum property (Note 7)	**2,012,720**	1,818,388
	8,782,681	3,120,420
Loss before income taxes recovered	**(2,932,357)**	(1,942,844)
Income taxes recovered	**983,317**	975,545
Net loss	**(1,949,040)**	(967,299)
Retained earnings, beginning of year	**763,294**	1,730,593
Retained earnings (deficit), end of year	**$ (1,185,746)**	$ 763,294

Consolidated Statement of Changes in Financial Position

	1986	1985
Cash provided from (used for)		
Operations		
Net loss	**$ (1,949,040)**	$ (967,299)
Depreciation and depletion	**2,309,302**	37,113
Deferred income taxes	**(812,556)**	(975,545)
Write-off of petroleum property	**2,012,720**	1,818,388
	1,560,426	(87,343)
Cash provided from (used for)		
Receivables	**4,281,353**	(4,409,353)
Payables and accruals	**2,843,021**	(91,103)
Deferred grants	**(10,146)**	5,894
	8,674,654	(4,581,905)
Financing		
Proceeds from long term debt	**21,607,793**	4,393,073
Proceeds from bank indebtedness	**8,227,727**	23,720,471
Increase in unamortized foreign exchange loss	**(3,755,296)**	(1,378,793)
Repayment of other loans	**(262,583)**	
Decrease in other assets	**18,164**	31,213
Minority interest	**530,729**	1,986,861
	26,366,534	28,752,825
Investing		
Costs incurred in petroleum and natural gas properties	**(36,346,019)**	(22,765,320)
Purchase of equipment and leasehold improvements	**(31,883)**	(37,958)
	(36,377,902)	(22,803,278)
Net cash provided (used)	**(1,336,714)**	1,367,642
Cash and short term deposits, beginning of year	**12,671,888**	11,304,246
Cash and short term deposits, end of year	**$ 11,335,174**	$ 12,671,888

Notes to Consolidated Financial Statements

For the year ended [illegible]

1. Accounting policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries.

A significant part of the Company's activities is conducted jointly with others and accordingly, the accounts reflect only the Company's proportionate interest in these activities.

(b) Petroleum, natural gas and mineral investments

Petroleum, natural gas and mineral exploration activities are accounted for using the Full Cost Accounting Method for preproduction companies. All costs of acquisition, exploration for and development of petroleum, natural gas and mineral reserves are capitalized on a prospect block basis. Costs capitalized include overhead related to exploration and development activities, as well as interest and foreign exchange gains and losses related to funds borrowed for those activities. The amount of Petroleum Incentives Program grants earned is accounted for as a reduction of exploration expenditures.

Depletion expense for exploration activities is not calculated until such time as production commences. Depletion expense for producing properties in Western Canada is calculated based upon the unit-of-production method.

(c) Foreign currency translation

Liabilities have been translated to Canadian dollars using the exchange rate on March 31, 1986. Transactions during the year are recorded using the exchange rate in effect at the date of the transaction.

(d) Income taxes

The Company follows the tax allocation method of accounting for income taxes in its subsidiary company, whereby deferred taxes are provided to the extent that current taxes have been reduced by claiming capital cost allowance and exploration, development and acquisition expenses in excess of the related depletion, depreciation and amortization provided in the financial statements.

2. Petroleum and natural gas investments

	1986	1985
Offshore Nova Scotia	**$104,875,876**	$ 82,671,569
Producing properties, Western Canada	**9,532,767**	
	$114,408,643	$ 82,671,569

3. Other assets

	1986	1985
Unamortized foreign exchange loss	**$ 4,168,102**	$ 412,806
Mineral properties	**493,711**	158,105
Sundry	**8,151**	26,315
	$ 4,669,964	$ 597,226

The unamortized foreign exchange loss is being amortized over the five year term of the loan to which it relates and matures on May 31, 1987.

4. Bank indebtedness

The Company has arranged to borrow funds on a multi-currency option basis at varying terms and interest rates. At March 31, 1986 the loans were denominated in U.S. dollars and were secured by an assignment of Petroleum Incentive Grants receivable which totalled $6,417,993.

5. Long term debt

The Company has borrowed funds on a multi-currency option basis for a 5 year term maturing May 31, 1987. As at March 31, 1986 the loan was denominated in U.S. dollars with a Canadian equivalent of $73,756,979. This loan is guaranteed by the Province of Nova Scotia.

During the year, the Company borrowed $11.1 million to acquire producing oil and gas properties in Western Canada. The loan will be repaid from net revenues from the properties and bears no other security. The balance of the loan at March 31, 1986 is $9,200,341.

6. Petroleum and natural gas income

In summer 1985 the Company purchased an interest in certain producing oil and natural gas properties in Western Canada. After all direct expenses, this transaction resulted in a net income of $798,956 for the year.

7. Write-off of petroleum property

During the year the Company relinquished to the Crown its interest in a portion of a prospect block on the Scotian Shelf. All costs associated with this relinquished interest have been written off.

8. Comparative figures

The comparative figures have been restated to conform to the new account groups for 1986.

9. Contingency

In prior years, the Company through its subsidiary Novaco Limited, has conducted exploratory mining at Springhill, but reclamation of the lands disturbed was not undertaken or provided for. Another company is proposing to conduct underground mining at the same site and if undertaken, Novaco is not responsible for reclamation of the total land area. Costs have not been determined and no provision has been made for this liability. This matter will be accounted for in the year that the outcome is determined.

10. Losses

The Company, through its subsidiary Nova Scotia Resources (Ventures) Limited, has losses carried forward for income tax purposes totalling $10.5 million which are due to expire in varying amounts over a period from March 31, 1990 to March 31, 1993. The tax benefit related to these losses has not been taken into account in the determination of deferred income taxes. These losses will expire unless applied against taxable income of the Company before those dates.

11. Future operations of Navaco Limited

Coal mining operations of the Company's wholly owned subsidiary Novaco Limited ceased during the year. The role and future activities of Navaco Limited are under review.

Nova Scotia Resources Limited

BOARD OF DIRECTORS

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Nova Scotia Resources Limited
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Government of Nova Scotia
Halifax, N.S.

J. Ewart Blanchard
Consultant
N.S. Research Foundation
Corporation
Dartmouth, N.S.

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N.S. Department of Finance
Halifax, N.S.

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Calgary, Alberta

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Chief Operating Officer
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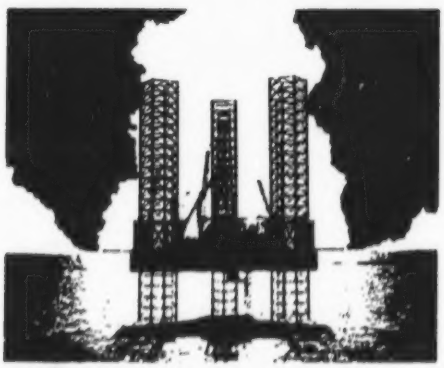
Halifax, N.S.

Vice President
A. Lee Horne
Halifax, N.S.

Secretary
Joseph A.F. Macdonald
McInnes, Cooper & Robertson
Halifax, N.S.

PRINCIPAL SUBSIDIARIES

Nova Scotia Resources Exploration Limited	100%
Nova Scotia Resources (Ventures) Limited	99.99%
Novaco Limited	100%
Canadian Offshore Resources Exploration Limited (COREL)	53.226%



Nova Scotia Resources Limited

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